A crash course in the CRS

An examination of the OECD's Common Reporting Standard

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Abstract

- All major financial centres have committed to the Common Reporting Standard (CRS) except the US. The Early Adopters have committed to exchange information with each other starting in 2017 for tax year 2016.

- Entity classification is a crucial aspect of the CRS. It must be determined whether companies, foundations, trusts, etc, are Financial Institutions, passive Non-Financial Entities (NFEs), or active NFEs. This will determine the type and amount of data exchanged.

- The Look Through approach is designed to penetrate legal structures of all kinds, identify beneficial owners and report them to respective home-country tax authorities.

- Information to be reported includes names of individuals, addresses, tax identification numbers, names of banks, account numbers, account balances and gross amounts of income.

- Two competing financial centres that are on divergent paths are examined: the US as a non-participant and Switzerland as an MCAA signatory.

- A flow chart outlining the reporting hierarchy for the CRS can be found on page 31 and a glossary on page 39.

The OECD's Common Reporting Standard (CRS)[1] is a multilateral, fully reciprocal automatic-exchange-of-information mechanism that sets out the due diligence and reporting rules of the standard, and should be read together with its annexed Commentary. The CRS and its Commentary have been incorporated by reference into the *Multilateral Competent Authority Agreement* (MCAA) and are binding on signatories. The *Implementation Handbook*[2] is a practical guide developed to assist government officials;

1. Bit.ly/1TLybJE

2. Available at bit.ly/1HRjedk. STEP has published some additional guidance on the *Implementation Handbook*: bit.ly/1S1DVvj

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it has not been incorporated into the MCAA and is not binding on signatories.

The CRS was unveiled by the OECD in February 2014, and was endorsed by the G20 later that month in Sydney, Australia. The so-called 'Early Adopters'[3] endorsed the standard and committed to begin exchanging information automatically with each other by 2017 for tax year 2016. In May 2014, all OECD members and a number of non-OECD members issued a declaration endorsing the automatic standard. In July 2014, the OECD Council approved the new standard. In a mass signing ceremony on 29 October 2014 in Berlin, Germany, 52 jurisdictions signed the MCAA; a few others signed along the way.

A year later, on 30 October 2015, in Bridgetown, Barbados, another 13 jurisdictions signed the MCAA. The MCAA presently has 80 signatories.[4] Other jurisdictions, although not signatories to the MCAA, have committed to exchange information automatically by 2018, including the financial centres of the Bahamas, Singapore, UAE and Uruguay.[5] The US is the only major financial centre that has not committed to the automatic standard.

The information to be exchanged automatically under the CRS is broad, and includes names, dates and places of birth, addresses, tax residences, and tax identification numbers of 'Reportable Persons', as well as the names of Financial Institutions, account numbers, account balances and gross amounts of interest, dividends, capital gains and other income.

IMPLEMENTATION OF AUTOMATIC EXCHANGE

There are two ways for jurisdictions to comply with the automatic standard. Jurisdictions may enter into bilateral agreements that incorporate the due diligence and reporting rules of the CRS. In the alternative, jurisdictions may take a multilateral approach by becoming parties to the MCAA, which is a framework agreement designed to implement the automatic standard on a multilateral basis. In order to become parties to the MCAA, which incorporates the operative automatic-exchange-of-information provisions of the amended *Convention on Mutual Administrative Assistance in Tax Matters* (the Convention),[6] jurisdictions must first join the amended Convention.

There is considerable speculation that all signatories of the MCAA will simply exchange information automatically with each other without further ado. In the various declarations of the Early Adopters, they clearly manifest their intent to adopt the CRS *among each other*.[7] However, the MCAA does not oblige all signatories to exchange information automatically with each other, nor does the CRS or its Commentary impose such an obligation. Notwithstanding, the *Handbook* appears to imply that some form of commitment exists between all jurisdictions that have signed the MCAA, or that have committed to adopt the CRS, to exchange information automatically with each other.[8] Such a notion is seemingly inconsistent with statements made by the OECD that 'its design as a framework agreement means the MCAA always ensures that each signatory has ultimate control over exactly which exchange relationships it enters into and that each signatory's standards on confidentiality and data protection always apply'.[9] Indeed, the MCAA is not self-executing. In order to activate automatic exchange under the MCAA, a further 'mutual agreement'[10] between any two counterparties is required, and a notification[11] must be filed with the OECD Secretariat.

DUE DILIGENCE RULES

Under the CRS, 'Financial Institutions' (FIs)[12] that are tax-resident in jurisdictions which have adopted the standard have due diligence and reporting obligations. The purpose of the CRS due diligence rules is to establish the tax residence of

3. Their statement can be accessed at bit.ly/251MjlM
4. Bit.ly/1plT68V
5. Bit.ly/1HExppt
6. MCAA, s2, article 1.1
7. Bit.ly/251MjlM
8. *Handbook*, paragraph 31, page 21
9. Bit.ly/1MkCW4R
10. MCAA, s1(1)(h) and s7(1)(f), and amended Convention, article 6
11. MCAA, s7. See also *Implementation Handbook*, paragraph 51, page 26
12. CRS, section VIII, subparagraph A(3), page 44

individuals, as well as the tax residence and nature of 'Account Holder' entities, i.e. whether they are properly classified as FIs or 'Non-Financial Entities' (NFEs). The CRS provides specific procedures to be followed by Reporting FIs, including documents that may be relied upon, whether existing anti-money laundering/know-your-client documents or self-certifications, presumptions, types of searches to be conducted, and so on.

FIs are required to first conduct due diligence to identify 'Reportable Accounts'[13] held by 'Reportable Persons',[14] i.e. entities or individuals tax-resident in Reportable Jurisdictions.[15] In the case of *individual* 'Account Holders',[16] Reporting FIs must determine the tax residence of such individuals to determine whether the accounts are Reportable Accounts; the rules distinguish between *pre-existing* accounts,[17] and *new* accounts.[18] In the case of *entity* Account Holders, Reporting FIs must determine whether accounts are held by individuals or entities that are tax-resident in Reportable Jurisdictions, or by passive NFEs with one or more 'Controlling Persons'[19] that are tax-resident in Reportable Jurisdictions; the rules also distinguish between *pre-existing* entity accounts,[20] and *new* entity accounts.[21] The CRS has developed an optional 'Wider Approach', which allows FIs to conduct due diligence on all non-residents.[22]

The standard approach to reporting set out in the CRS and its Commentary requires FIs to report to the local tax authority, known as the 'Competent Authority', the required identification and financial information on Reportable Accounts held by Reportable Persons tax-resident in Reportable Jurisdictions – that is, jurisdictions with which there is an agreement in place for the automatic exchange of information. The Wider Approach to reporting would allow Reporting FIs to report identification and financial information on all non-residents to their local Competent Authority regardless of whether the Competent Authority has an agreement in place for automatic exchange with the jurisdictions of residence of such persons.[23] In turn, the Competent Authority where such Reporting FIs are tax-resident will then exchange the pertinent information with the Competent Authorities of the Reportable Jurisdictions.

Under optional CRS procedures, jurisdictions may allow Reporting FIs to apply a *de minimis* threshold of USD250,000 for pre-existing entity accounts, which would not need to be reviewed, identified or reported.[24] In addition, they may allow Reporting FIs to apply the same due diligence procedures for new accounts as for pre-existing accounts, as well as the application of the same due diligence procedures for high-value accounts as for low-value accounts.[25]

ENTITY CLASSIFICATION

Since FIs have reporting obligations and NFEs do not, the most important threshold question is whether the entity is an FI or an NFE. There are four types of possible FI classifications: Custodial Institutions, Depository Institutions, Investment Entities or Specified Insurance Companies.[26] If an entity is not an FI, then it will necessarily be an NFE.[27] A passive NFE[28] is defined in the negative as an entity that is not an active NFE.[29] An entity is an active NFE if less than 50 per cent of its income is passive and less than 50 per cent of its assets produce or are held for the production of passive income. As a CRS anti-avoidance rule, Type B Investment Entities resident in Non-Participating Jurisdictions must also be treated as passive NFEs.[30] Translating CRS jargon to the real world, Depository Institutions are banks, Custodial Institutions are securities or brokerage firms, and Investment Entities come in two types: Type A and Type B. Type A Investment Entities are typically trust companies and asset management firms, and Type B Investment Entities are typically trusts, portfolio holding companies, mutual funds, etc.

13. CRS, section VIII, subparagraph D(1), page 57
14. CRS, section VIII, subparagraph D(2), page 57
15. CRS, section VIII, D(4), page 57
16. CRS, section VIII, subparagraph E(1), page 60; CRS Commentary, paragraph 138, page 200
17. CRS, section III, pages 31–37
18. CRS, section IV, subparagraph A, page 37
19. CRS, section VIII, subparagraph D(6), page 57; CRS Commentary, paragraphs 132–135, pages 198–199
20. CRS, section V, subparagraph D, pages 38–39
21. CRS, section VI, subparagraph A, pages 40–42
22. CRS, annex 5, paragraphs 1 and 2, page 284
23. *Handbook*, paragraph 24(7), page 19
24. CRS, section V, subparagraph A, page 38
25. CRS, section II, paragraph E, page 31
26. CRS, section VIII, subparagraph A(3), page 44
27. CRS, section VIII, subparagraph D(7), page 57
28. CRS, section VIII, subparagraph D(8), page 58; CRS Commentary, paragraph 123, page 195. See also *Handbook*, paragraph 207, page 79
29. CRS, section VIII, subparagraph D(9)(a), page 58
30. CRS, section VIII, subparagraph D(8), page 58. See also CRS Commentary, paragraph 123, page 195

> **A professional trust company that typically provides trust and company management services would almost certainly be treated as a Type A Investment Entity**

Under the CRS, a Type A Investment Entity[31] is any Entity '... that *primarily conducts as a business*... for or on *behalf of a customer... investing, administering, or managing* Financial Assets or money on behalf of other persons'. In turn, 'primarily conducts' requires that '... the Entity's gross income attributable to the relevant activities equals or exceeds 50% of the Entity's gross income . . . '[32] Meanwhile, a Type B Investment Entity[33] must meet a two-pronged 'Gross Income' and 'Managed By' test. First, the Gross Income[34] test requires that the entity's income be 'primarily attributable' (more than 50 per cent) to investing in Financial Assets.[35] Second, the Investment Entity must be 'managed by' a Custodial Institution, Depository Institution, Specified Insurance Company or a Type A Investment Entity. The Managed By test requires that the managing entity invest, administer or manage Financial Assets on behalf of other persons.[36] However, the Managed By test will not be met unless the managing entity has *discretionary authority* to manage the assets[37] of the Type B Investment Entity.

TRUST COMPANIES AS FIs

A professional trust company that typically provides trust and company management services would almost certainly be treated as a Type A Investment Entity. Trust companies have 'customers', and the provision of trustee services is almost certainly captured by 'administering or managing' assets on behalf of other persons, and the trust company will be deemed to 'primarily conduct as a business' such services if a majority of the trust company's fee income is from trustee services related to trusts holding Financial Assets. However, if a majority of its fee income is from trusts holding Non-Financial Assets, then the trust company would be an NFE. It is noteworthy that the classification of a trust company as an FI is not consistent with the Financial Action Task Force *Recommendations* (February 2012), which treat trust and company service providers as a Designated Non-Financial Businesses and Professions (DNFBPs).[38]

TRUSTS AS FIs

In turn, trusts administered by professional trust companies are typically not Type A Investment Entities because they are not in 'business', do not have 'customers', do not 'administer or manage' Financial Assets for other persons, and do not earn the type of income necessary to qualify as Type A Investment Entities.

Instead, trusts would be treated as Type B Investment Entities provided they meet the two-pronged test. If the trust fails either the Gross Income test or the Managed By test, then it would be treated as an NFE. The Gross Income test would easily be met by trusts holding Financial Assets directly at trust level. However, for a variety of reasons, most trusts do not hold accounts at trust level, but hold Financial Assets through underlying companies. Since shares of underlying companies are considered Financial Assets, under the CRS any income deriving therefrom would also be considered to be derived from Financial Assets for purposes of the Gross Income test. This would hold true even though the assets held by the underlying company are non-financial (real estate, yachts, aircraft, artwork, etc). Thus, for the Gross Income test, according to the *Handbook*, there is no 'Look Through' to the *nature* of the assets held by the underlying company.[39] Separately, it is not clear whether trusts holding assets through underlying companies would necessarily have any 'income' at all. Many, if not most, trusts fund underlying companies through interest-free debt rather than capital. When payments are made by the underlying company to the trust, for the payment of trust expenses such as trustee fees, the payments are often documented as repayment of debt and not as dividend distributions or other types of income.

31. See CRS, section VIII, subparagraph A(6)(a)(iii), page 44
32. CRS, section VIII, subparagraph A(6), page 45
33. CRS, section VIII, subparagraph A(6)(b), page 44
34. CRS, section VIII, subparagraph A(6)(b), pages 44–45
35. CRS, section VIII, subparagraph A(7), page 45
36. CRS, section VIII, subparagraph A(6)(b), page 44
37. CRS Commentary, paragraph 17, page 162
38. FATF *Recommendations* (February 2012), glossary, pages 113–114
39. See *Handbook*, Annex 1, 'Frequently Asked Questions', 'Indirect Investments in Real Estate', page 113

Nonetheless such payments may be treated as income to the trust for purposes of the Gross Income test.

The Managed By test would necessarily be met if the trustee is a professional trust company. As we have seen, the provision of trust services is likely to be considered 'administering or managing' Financial Assets on behalf of other persons. In addition, the Managed By test would also be met if the trust holds Financial Assets at trust level that are managed by a professional asset manager with *discretionary authority*. However, if the trust holds Financial Assets through an underlying company – which is the rule rather than the exception – which are professionally managed with *discretionary authority*, it is not clear whether one should disregard the separate legal personality of the corporation for purposes of the Managed By test.

UNDERLYING COMPANIES AS FIs

Underlying companies of trusts holding Financial Assets, and indeed stand-alone companies, would not typically be Type A Investment Entities because they are not in 'business', do not have 'customers', do not 'administer or manage' Financial Assets for other persons, and the type of income such companies earn would not qualify.

Instead, underlying companies would be Type B Investment Entities if they meet the Gross Income test as well as the Managed By test. The Gross Income test would be met if 50 per cent or more of the overall income of the underlying company is derived from investing in Financial Assets, which would be the case for most companies holding portfolio investments.

The Managed By test would be met if the assets of the company are managed by a bank, securities firm or professional asset manager with *discretionary authority* over investments. With respect to companies managed by individual directors furnished by trust companies, individual directors do not satisfy the Managed By test because natural persons cannot be FIs. Corporate director entities, which are used by trust companies to provide directors' services, are special purpose vehicles that typically do not meet the criteria for Type A Investment Entities, and certainly do not invest, administer or manage assets with *discretionary authority*. Therefore, the better view is that the Managed By test is not met by corporate director entities. However, the BVI *Guidance Notes* allow BVI companies to take the position that corporate directors do confer Managed By status.[40]

TAX RESIDENCE

The tax residence of entities is a crucial aspect of the CRS due diligence and reporting process. Since FIs have reporting obligations and NFEs do not, it must be determined whether the FI is tax-resident in a Participating Jurisdiction.[41] If an FI is tax-resident in a particular Participating Jurisdiction, it will be subject to the CRS due diligence and reporting rules of such jurisdiction.

A trust that is an FI will be considered to be tax-resident where one or more of the trustees are resident.[42] However, where an FI does not have a tax residence, because it is fiscally transparent or resident in a jurisdiction that does not have income tax, it is considered to be resident for CRS purposes in the jurisdiction where it is incorporated, where it has its place of effective management, or where it is subject to financial supervision.[43] Where an FI is resident in more than one jurisdiction, it will be subject to the reporting rules of the jurisdictions where it maintains Financial Accounts.[44]

The tax residence of NFEs is relevant to the extent that reporting FIs must report such entities to their jurisdiction of residence, if resident in a Reportable Jurisdiction. If the entity is a partnership or is fiscally transparent with no tax residence, then one should look to the effective place of management,[45] which is defined as the place where key management and commercial decisions are made.[46]

PARTICIPATING JURISDICTIONS

A 'Participating Jurisdiction Financial Institution'[47] is an FI that is tax-resident in a Participating Jurisdiction.[48] For purposes of determining the

40. *Guidance Notes*, International Tax Authority, 20 March 2015, §2.9.1, page 22
41. CRS, section VIII, subparagraph A(2), page 44
42. CRS Commentary, paragraph 4, pages 158–159
43. *Idem*
44. CRS Commentary, paragraph 5, page 159; *Handbook*, paragraph 83, page 37
45. CRS, section VIII, subparagraph D(3), page 57
46. CRS Commentary, paragraph 109, page 192
47. CRS, section VIII, subparagraph A(2), page 44
48. CRS, section VIII, subparagraph D(5), page 57

residency of entities, such as corporations, partnerships and trusts, jurisdictions that have implemented the CRS are treated as Participating Jurisdictions.[49] However, the broader CRS definition of a Participating Jurisdiction is one with respect to which there is an agreement in place with another jurisdiction for automatic exchange and which appears on a published list.[50]

To deal with the initial transitional period before bilateral agreements are in place, and to avoid application of the Look Through anti-abuse provision, some jurisdictions have adopted a 'white list' approach, and will treat as Participating Jurisdictions those jurisdictions that have signed the MCAA or that have otherwise committed to implementing the CRS, even though no bilateral agreements are in place.[51] Thus, entities resident in white-listed jurisdictions would not be subject to the CRS anti-abuse rule, which requires Participating Jurisdiction FIs to treat Type B Investment Entities resident in Non-Participating Jurisdictions as passive NFEs and Look Through and report their Controlling Persons. The British Virgin Islands,[52] Cayman,[53] Jersey,[54] and the UK[55] are examples of jurisdictions that have adopted this approach. Save for the Early Adopters, these white lists are more like wish lists, where jurisdictions publicly announce their desired future exchange partners.

On the other hand, a Reportable Jurisdiction[56] is one with respect to which there is a bilateral agreement in place to provide automatic information exchange as required by the CRS, and which appears on a published list.

REPORTING BY FIs

Reporting obligations fall upon FIs that are 'Reporting Financial Institutions',[57] which essentially are FIs tax-resident in Participating Jurisdictions, unless they fall into a narrow category of excluded Non-Reporting FIs, such as trusts that are FIs where the trustees are Reporting FIs.[58] Reporting FIs are obliged to report Reportable Accounts held by Reportable Persons, as well as accounts held by passive NFEs that are Reportable Persons with one or more Controlling Persons that are Reportable Persons.[59]

FIs that are Type B Investment Entities must report persons or entities holding Financial Accounts,[60] including Equity and Debt Interests.[61] There is no *de minimis* rule for Equity Interests; thus *any* Equity Interest must be reported. Under the CRS, shareholders are Equity Interest holders. If the shareholder is another FI, there would be no reporting because FIs are excluded from the definition of Reportable Person and FIs do not report each other.[62] If the shareholder is an active NFE, it would be reported to its jurisdiction of tax residence. However, if the shareholder is a passive NFE, it would be reported, as well as its Controlling Persons, to their respective jurisdictions of tax residence. Type A Investment Entities do not report their Equity Interest holders because such Equity Interest holders are not deemed to hold Financial Accounts and are not reportable.[63] However, Type B Investment Entities resident in Non-Participating Jurisdictions are treated as passive NFEs,[64] and Reporting FIs must Look Through and report their Controlling Persons, if resident in Reportable Jurisdictions. This CRS anti-avoidance rule is limited to Type B Investment Entities, and does not extend to Type A Investment Entities.

Trust companies, like all companies, have shareholders. However, in the case of trust companies that are Type A Investment Entities, the shareholders of such trust companies are not deemed to hold Financial Accounts in the trust company because, as we have seen above, Equity Interest holders in Type A Investment Entities are not deemed to hold Financial Accounts in the Investment Entity, and will not be reported. It is important to note that neither trusts administered by trust companies, nor settlors, nor beneficiaries of such trusts are considered to

49. CRS Commentary, paragraph 4, page 159
50. CRS, section VIII, subparagraph D(5), page 57
51. *Handbook*, paragraph 31, page 21
52. *List of Participating Jurisdictions*, International Tax Authority, BVI (11 February 2016)
53. Bit.ly/1XsZkiw
54. Bit.ly/1RLVmNH
55. Bit.ly/1iswvnV
56. CRS, section VIII, subparagraph D(4), page 57
57. CRS, section VIII, subparagraph A(1), page 43
58. CRS, section VIII, subparagraph B(1)(e), page 46
59. CRS, section I, subparagraph A(1), page 29, and CRS, section VIII, subparagraph D(1), page 57
60. CRS, section VIII, subparagraph C(1)(a), page 50
61. CRS, section VIII, subparagraph C(4), page 51. CRS Commentary, section VIII, paragraphs 69–71, page 178. See also *Handbook*, paragraphs 212–217, pages 80–81
62. CRS, section VIII, subparagraph D(2)(vi), page 57
63. CRS, section VIII, subparagraph C(1)(a), page 50
64. CRS, section VIII, subparagraph D(8), page 58. See also CRS Commentary, paragraph 123, page 195

hold Equity Interests and hence Financial Accounts in the trust companies themselves. Trusts that are FIs and that are administered by trust companies that are also Reporting FIs are considered to be Non-Reporting FIs.[65] As a consequence, the trustees of such trusts, and not the trusts themselves, have the obligation to report the Equity Interest holders of such trusts.

In the case of trusts that are FIs, settlors are considered to hold Equity Interests in the trusts, and hence Financial Accounts, regardless of whether the trust is revocable or the settlor is excluded from benefit. The *Handbook* – which is not binding – confirms that settlors should be reported as to the entire value of the trust fund'.[66]

“Discretionary Beneficiaries must only be reported if distributions are actually paid or made payable to them, and they must be reported only as to the value of such distributions

By contrast, the BVI *Guidance Notes* provide that, if trusts are revocable, the Equity Interests of settlors should be the entire value of the trust funds, but, if the settlors are excluded from the trusts, their Equity Interests should be nil, but the accounts will still be Financial Accounts and hence reportable.[67] This seems to be a more sensible approach. It is clear that settlors should be reported as to the value of payments made during the reporting period.[68] However, the valuation of such Equity Interests is not clearly defined in the CRS or its Commentary.[69]

Regarding Mandatory Beneficiaries, they are deemed to hold Equity Interests in the trusts, and the value of such interests must be calculated and reported,[70] as well as the value of any distributions made to such beneficiaries during the reporting period.[71] Discretionary Beneficiaries, however, must only be reported if distributions are actually paid or made payable to them, and they must be reported only as to the value of such distributions.[72] In addition, '... any other natural person exercising ultimate effective control over the trust' is considered to be an Equity Interest holder.[73] According to the *Handbook*, this includes trustees, as well as legal entities that act as settlors and beneficiaries,[74] and, according to the STEP *Guidance Notes*, protectors should be included as well.[75] In this latter case, the Reporting FIs must Look Through such entities, identify their Controlling Persons and treat them as Equity Interest holders.[76]

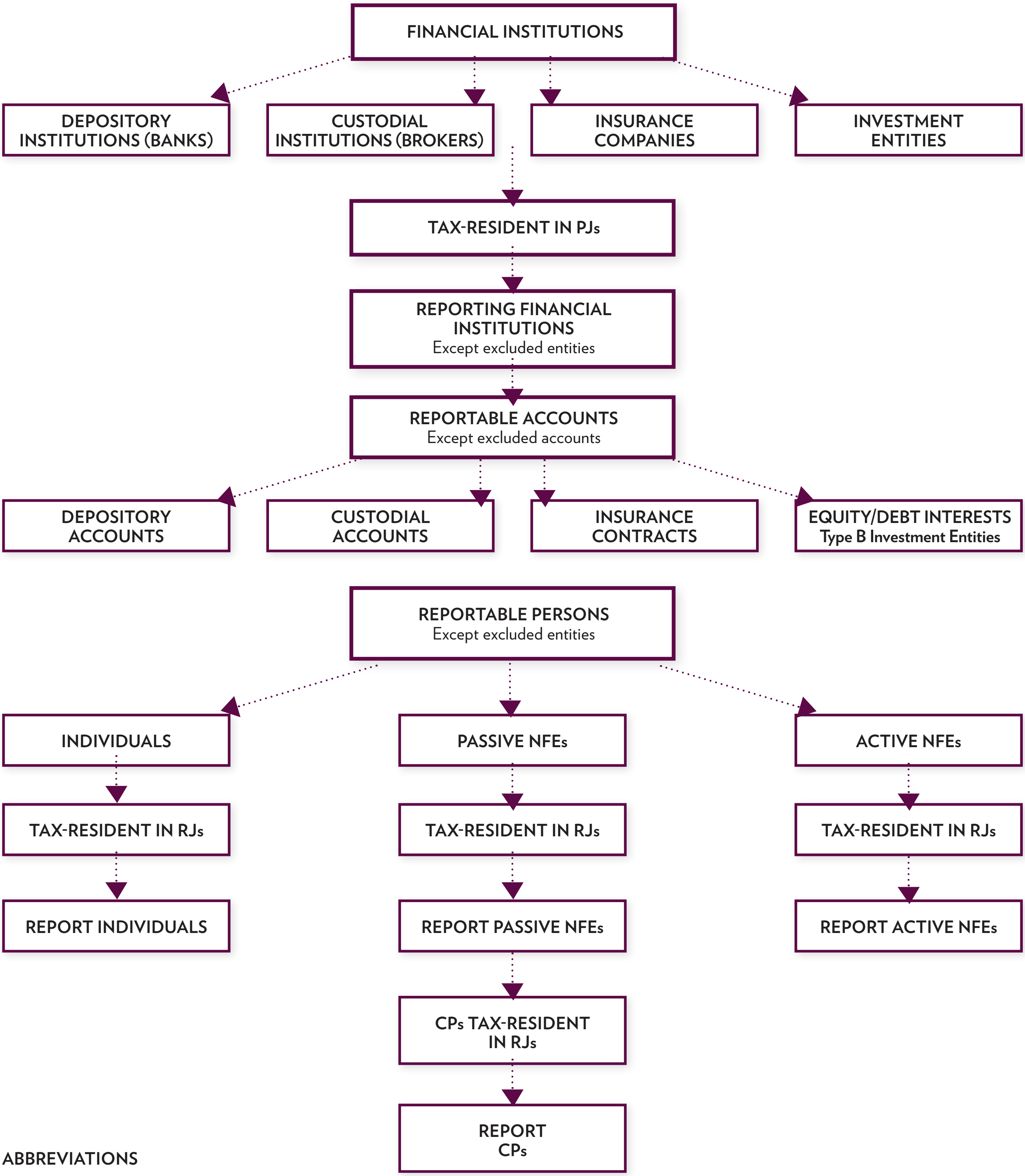
In the case of partnerships that are FIs, persons holding *any* capital or profits interests would be deemed to hold Equity Interests[77] in the partnerships, and must be reported if such partners are tax-resident in Reportable Jurisdictions. The same logic would apply to corporations, and persons holding *any* number of shares would be deemed to hold Equity Interests in such corporations, and must be reported if tax-resident in Reportable Jurisdictions. Each Equity Interest holder must be reported as to the value of such interest and any payments made to such Equity Interest holder. In the case of investment funds that are FIs, where shares are held by Custodial Institutions, the Custodial Institution is responsible for reporting and not the Investment Entity.[78]

REPORTING OF NFEs

NFEs have no direct reporting obligations, but must typically provide self-certifications and other documentation to Reporting FIs where they hold accounts. As we have seen, Reporting FIs are obliged to report passive NFEs, and Look Through passive NFEs and report their

65. CRS, section VIII, subparagraph B(1)(e), page 46; CRS Commentary, paragraphs 55–56, page 174, and *Handbook*, paragraph 209, page 79
66. *Handbook*, paragraph 220, pages 81–82 and Table 7, page 82. See also STEP *Guidance Notes*, paragraph 13(a)(i)
67. BVI *Guidance Notes*, §6.8, page 56 (20 March 2015): bit.ly/1plTRPi
68. CRS, section I, subparagraph A(7), page 30; CRS Commentary, paragraph 21, page 101. See also *Handbook*, paragraph 220, pages 81–82
69. CRS, section I, subparagraph A(4), page 29; CRS Commentary, paragraph 12, page 98
70. CRS, section I, subparagraph A(4), page 29; CRS Commentary, paragraph 12, page 98
71. CRS, section VIII, subparagraph C(4), page 51 ; CRS Commentary, paragraph 70, page 178. See also *Handbook*, Table 7, page 82
72. CRS, section VIII, subparagraph C(4), page 51; CRS Commentary, paragraph 70, page 178. See also *Handbook*, paragraph 214, pages 80, 82
73. CRS, section VIII, subparagraph C(4), page 51
74. *Handbook*, paragraph 214, page 80
75. STEP *Guidance Notes*, paragraph 13(a)(ii)
76. *Idem*
77. CRS, section VIII, subparagraph C(4), page 51
78. CRS Commentary, paragraph 71, page 178

CRS REPORTING HIERARCHY



ABBREVIATIONS

RJ: Reportable Jurisdiction
CP: Controlling Person
PJ: Participating Jurisdiction
NFE: Non-Financial Entity

Controlling Persons, provided they are tax-resident in Reportable Jurisdictions.

In the case of trusts that are passive NFEs, Reporting FIs must report passive NFE trusts that are tax-resident in Reportable Jurisdictions, which normally means the jurisdiction where the trustees are resident, as well as their Controlling Persons that are tax-resident in Reportable Jurisdictions. The Controlling Persons of trusts include the settlors, trustees, beneficiaries and protectors, regardless of whether such persons actually exercise any control.[79]

For purposes of Controlling Persons, the CRS does not distinguish between revocable and irrevocable trusts, or between trusts where settlors are beneficiaries and those where they have been excluded from benefit, and requires settlors to be reported regardless. In addition, the CRS does not distinguish between Mandatory Beneficiaries and Discretionary Beneficiaries.

Under the CRS optional provisions, jurisdictions may allow FIs to align the reporting treatment of Discretionary Beneficiaries of trusts that are passive NFEs with the reporting treatment of Discretionary Beneficiaries of trusts that are FIs.[80] In addition, the reference to '... any other natural person(s) exercising ultimate effective control over the trust,'[81] is intended to apply to legal entities acting as settlors and beneficiaries.[82] In such situations, the Reporting FI must also Look Through the entities and report their Controlling Persons. The type of financial information that must be reported with respect to each Controlling Person of passive NFE trusts is the entire value of the trust fund, as well as the entire amount of gross income paid to the passive NFE trusts.[83] However, Controlling Persons of passive NFE trusts would not be considered to be Reportable Persons if they are resident in the same jurisdiction as the Reporting FIs, unless the jurisdiction adopts the Wider Approach.[84]

Similarly, natural persons holding 'Controlling Ownership Interests' in corporations or partnerships that are passive NFEs are treated as Controlling Persons,[85] and must be reported if tax-resident in Reportable Jurisdictions. Depending on the type of legal entity, and the facts and circumstances, a Controlling Ownership Interest may be defined as an ownership interest of more than 25 per cent. Thus, a shareholder or partner holding more than a 25 per cent ownership interest would be considered to be a Controlling Person of a passive NFE and reported, if tax-resident in a Reportable Jurisdiction. Such person would be reported as to the entire value of assets held by, and gross income paid to, the entity.

CONFIDENTIALITY SAFEGUARDS

Safeguards on confidentiality of exchanged information, as well as limitations on use, are set forth in the MCAA. The OECD has clearly stated that it would be inappropriate for Participating Jurisdictions to enter into bilateral agreements for automatic information exchange with jurisdictions that do not meet their standards on confidentiality. In case of breaches of confidentiality safeguards, Participating Jurisdictions may suspend[86] or terminate[87] automatic information exchange.

The Global Forum on Transparency and Exchange of Information for Tax Purposes will enforce compliance with the new automatic standard through a new Peer Review process, and will also publish new *Terms of Reference*, which are expected to define the criteria against which jurisdictions will be rated for compliance with the automatic standard. The Global Forum has recognised that many developing jurisdictions face special challenges in implementing automatic information exchange, and suffer from capacity constraints with respect to 'knowledge, political will, information technology, human resources, legal frameworks, rigorous confidentiality and data protection safeguards ...'[88] In the opinion of the author, automatic exchange of information would be inappropriate with many developing countries, where confidentiality and other safeguards are lacking. Many such countries suffer from weak institutions, high levels of

79. CRS, section VIII, subparagraph D(6), page 57. CRS Commentary, paragraph 134, pages 198–199. *Handbook*, paragraph 227, page 83
80. CRS Commentary, paragraph 134, page 199. See also *Handbook*, paragraph 229, page 84
81. CRS, section VIII, subparagraph D(6), page 57
82. *Handbook*, paragraph 230, page 84
83. CRS Commentary, paragraph 13, pages 98–99. *Handbook*, paragraph 236, page 85. See also Table 8, page 86
84. CRS, Annex 5, paragraph 5, pages 285–286. See also *Handbook*, paragraph 231, page 84
85. CRS Commentary, paragraphs 132–133, page 198. See also *Handbook*, paragraph 106, page 47, and Interpretative Note to FATF Recommendation 10, paragraph 5(b)(i)
86. MCAA, s7, article 3
87. MCAA, s7, article 4
88. Global Forum report to the G20, *Automatic Exchange of Information: A Roadmap for Developing Country Participation* (August 2014), paragraph 5, page 3

corruption, and taxpayers there have few real protections against abusive practices by domestic tax authorities.

The CRS was developed jointly by the G20 and the OECD, which represent the most economically powerful countries in the world. However, one should not confuse economically powerful countries with those that apply the rule of law. For example, Transparency International's *Corruption Perceptions Index* shows that even leading members of G20 and OECD suffer from corruption, including EU member states.[89]

THE FINANCIAL CENTRES

With the exception of the US, all major financial centres have now committed to the new automatic standard. The vast majority of the principal offshore financial centres have either signed the framework MCAA or have made commitments to implement the CRS. Bahrain, Nauru, Panama and Vanuatu have not committed and remain on the Global Forum's shortlist of 'non-committed jurisdictions'.[90] In reality, this shortlist is incomplete as there are at least 100 other non-committed jurisdictions, including offshore financial centres, Lebanon and Liberia.

It remains to be seen how the CRS will be implemented by the financial centres that have committed to the CRS, especially the Early Adopters that have committed to exchange information automatically *with each other* in 2017 for tax year 2016. Financial centres should expect a new round of Global Forum Peer Reviews specially designed for the CRS, as well as 'tougher incentives' in the form of the attendant threat of non-compliant ratings, blacklists or sanctions.

It is clear, however, that financial centres may refuse to exchange information with jurisdictions that do not meet *their* standards on confidentiality. A principal concern of participating financial centres is the risk of outflows to other financial centres that have not committed to the CRS. These outflows may be mitigated if onshore counterparties implement voluntary disclosure

89. www.transparency.org/cpi2014/results
90. Global Forum, *Statement of Outcomes*, Barbados (30 October 2015)

"Financial centres should expect a new round of Global Forum Peer Reviews specially designed for the CRS, as well as the attendant threat of non-compliant ratings, blacklists or sanctions

programmes. Indeed, the OECD recognises the importance of such programmes to the implementation of automatic exchange.[91] However, in the opinion of the author, voluntary disclosure programmes will not be entirely successful in preventing outflows as long as the US does not commit to the CRS.

Holdouts risk being treated as Non-Participating Jurisdictions and the application of the CRS anti-abuse measure that requires Reporting FIs to treat Type B Investment Entities resident in such Non-Participating Jurisdictions as passive NFEs, with the obligation to Look Through and report their Controlling Persons, etc. The consequences are potentially serious.

THE US

The US was rated largely compliant by the Global Forum in its combined Phase 1 and Phase 2 Peer Review[92] for the OECD's on-request standard. However, the Peer Review report identified a number of weaknesses, including missing or incomplete ownership and identity information related to single-member limited liability companies, etc.

Historically, the US has been somewhat of a pioneer in exchange of tax information through its network of some 61 double-tax treaties (DTTs) and some 33 tax information exchange agreements (TIEAs),[93] and regularly exchanges information on request with partner countries. In addition, the US was one of the five original signatories to the Convention, and on 27 May 2010, it executed a Protocol to join the amended Convention. However, the Protocol has not yet been ratified and the US remains bound by the terms of the original Convention.

91. OECD, *Update on Voluntary Disclosure Programmes: A Pathway to Tax Compliance* (August 2015)
92. Bit.ly/1UdlrtU
93. http://eoi-tax.org/jurisdictions/US#agreements

The US has been exchanging information automatically with certain treaty partners under DTTs and TIEAS for many years. The information exchanged automatically under DTTs and TIEAs is typically limited to US source 'fixed, determinable, annual or periodical' (FDAP) income[94] that is paid to accounts of non-resident individuals or foreign corporations and that is reported on Form 1042-S. However, some types of US source income, such as portfolio interest,[95] are not subject to either withholding or reporting on Form 1042-S. Any US tax return information, including 1042-S information, is treated as confidential and cannot be exchanged with foreign countries except pursuant to exchange-of-information instruments, which are protected by strict confidentiality safeguards.[96] Somewhat paradoxically, in this age of transparency, the countries with which the US actually exchanges information automatically are considered confidential by the Internal Revenue Service (IRS).[97] Some DTTs and TIEAs expressly authorise automatic information exchange, while others are silent on automatic exchange. However, the presence of automatic language in DTTs and TIEAs does not mean that the US exchanges information automatically, and the absence of automatic language does not mean that the US does not exchange information automatically.[98]

The US *Foreign Account Tax Compliance Act* (FATCA)[99] significantly expanded automatic information exchange between US and partner countries under pre-existing DTTs and TIEAs. FATCA is an automatic-exchange-of-information mechanism that unilaterally mandates foreign FIs to report information on accounts of US persons to the US under pain of a 30 per cent withholding tax on US source payments. The FATCA Bill passed in the US House of Representatives on 16 December 2009, with no Republican support,[100] and passed in the US Senate on 17 March 2010, with only 11 Republican senators voting in favour.[101] It came into effect on 1 January 2013. FATCA has recently been subjected to constitutional challenge.[102]

Neither the FATCA statute nor the FATCA regulations authorise reciprocal exchange of information with foreign tax authorities. However, the reciprocal Model I intergovernmental agreements (IGAs), which do authorise automatic information exchange, were developed to induce foreign tax authorities to share information with the US on US persons holding accounts overseas.

It is worth noting that all Model 1 reciprocal IGAs are supported by underlying exchange-of-information instruments, such as DTTs, TIEAs and the Convention. Under these IGAs, the US is obliged to exchange information with FATCA partner countries on certain types of US source income, such as deposit interest paid on depository accounts held by individual non-residents, US source dividends and other US source income paid to residents, whether individuals or corporations, but the US is not required to Look Through legal structures. However, foreign partner jurisdictions are obliged to provide far more extensive information, such as account balances, and various categories of gross income, such as interest, dividends, capital gains, etc, as well as Look Through legal structures. Clearly, the information exchange under FATCA reciprocal Model 1 IGAs is asymmetrical.

The deposit interest[103] reporting rules were introduced in 2012 as an express inducement to potential FATCA partner countries, and bear special mention. The rules apply to interest paid to non-resident alien individuals and require such income to be reported on Form 1042-S and exchanged automatically with DTT and TIEA partner countries. The regulations state that for 'interest aggregating $10 or more paid to a nonresident alien individual... the payor shall make an information return on Form 1042-S... for the calendar year in which the interest is paid'. In turn, interest subject to reporting means interest paid on US deposits to non-resident alien individuals who are residents of countries identified on a Revenue Procedure as having a DTT or TIEA with the US.[104]

94. *Internal Revenue Manual*, 'Automatic Exchange of Information Program', part 4, chapter 60, section I, 4.60.1.1.3.3(2) (09-19-2014)
95. See *Internal Revenue Code* (IRC) 871(h)
96. 26 *US Code* §6103(k)(4)
97. *Idem*, footnote 30, page 27
98. US Government Accountability Office report, *IRS's Information Exchanges with Other Countries Could Be Improved through Better Performance Information*, September 2011, page 18
99. Title V of the *Hiring Incentives to Restore Employment Act of 2010* (PL 111-147). Chapter 4, subtitle A, §§1471–1474 IRC
100. http://clerk.house.gov/evs/2009/roll991.xml
101. http://1.usa.gov/1YW7h0W
102. *Rand Paul et al* v *US Department of the Treasury, et al*, 3:15-CV-00250 (2015)
103. 26 *Code of Federal Regulations*, Part 1, §1.6049-4(b)(5)(i)
104. Regulations, *supra*, §1.6049-8

To date, some 73 jurisdictions have entered into Model 1 IGAs with the US, of which 53 are reciprocal and 20 are non-reciprocal.[105] In addition, some 25 jurisdictions have reached 'agreements in substance' with the IRS and are treated as having Model 1 IGAs in place.[106] Model 2 IGAs are not true automatic-exchange-of-information mechanisms. Foreign FIs are required to report information directly to the IRS and not to their local Competent Authorities. However, foreign FIs must first obtain the consent of US Account Holders before reporting to the IRS, and, if consent is not given, foreign FIs must report aggregate information directly to the IRS, and the IRS may then formulate a 'group' request to the foreign Competent Authority under the applicable DTT, TIEA or the Convention. The US may provide partner jurisdictions with information on request under the applicable instruments, but will not provide any information on an automatic basis. Thus far, some seven jurisdictions have entered into Model 2 IGAs,[107] and some seven jurisdictions are treated as having Model 2 IGAs in place.[108]

Statements made by the Department of the Treasury in connection with the reporting of deposit interest provide considerable insight as to how the US evaluates the suitability of foreign counterparties. The Department of the Treasury has stated that, even if a DTT or TIEA is in effect with respect to a particular country, information will not be exchanged if there are concerns about confidentiality or '*... other factors that would make the exchange of information inappropriate*'.[109] A Revenue Procedure sets forth a list of 34 countries deemed 'appropriate' to receive automatic information exchange of deposit interest. It is interesting to note that, although the US has reciprocal Model 1 IGAs with some 53 jurisdictions, only 34 of these jurisdictions have been determined to be appropriate for automatic information exchange of deposit interest.[110] The US appears to be quite willing to distinguish between appropriate and inappropriate counterparties, which may signal a more nuanced approach towards automatic information exchange than that of the OECD.

The imbalance in reporting standards between the CRS and FATCA is causing significant outflows from financial centres that have committed to the CRS and inflows to the US. Such outflows may be mitigated by voluntary disclosure programmes in local onshore jurisdictions, but would be significantly reduced if the US committed to the CRS.

THE US AS A NON-PARTICIPATING JURISDICTION

In view of the similarities between FATCA and the CRS, the OECD initially exempted US FIs from the requirement to apply '... the look through treatment for investment entities in Non-Participating Jurisdictions'.[111] However, this exemption is somewhat meaningless because the US does not, in any case, Look Through non-transparent legal entities in outbound information exchange. More recently, the OECD has reminded the US of the commitments made in the IGAs to 'achieve equivalent levels of reciprocal automatic information exchange'.[112]

However, since the US has not signed the MCAA or otherwise committed to the CRS, and the financial information reported automatically under FATCA reciprocal Model 1 IGAs is far less than that required under the CRS, and the US does not Look Through legal structures, the US certainly does not qualify as a Participating Jurisdiction under any technical interpretation of the term. The Cayman Islands, the British Virgin Islands, Jersey and the UK are examples of jurisdictions that have determined not to treat the US as a Participating Jurisdiction. The result of such treatment is that FIs resident in these jurisdictions will be obliged to treat Type B Investment Entities resident in the US, such as trusts, companies and mutual funds, as passive NFEs and Look Through and report the passive NFEs, as well as their Controlling Persons.

If it wished to do so, the US could qualify as a Participating Jurisdiction by executing the MCAA

105. http://1.usa.gov/1M567y8
106. *Idem*
107. *Idem*
108. *Idem*
109. 'Guidance on Reporting Interest Paid to Nonresident Aliens', *Internal Revenue Bulletin 2012-20* (14 May 2012)
110. See *Revenue Procedure 2015-50*
111. CRS, 'Introduction', paragraph 5, page 10 (July 2014)
112. Global Forum, *Statement of Outcomes*, annex 2, footnote 1 (28–29 October 2014)

or by ensuring that its existing exchange-of-information instruments otherwise meet the requirements of the CRS. According to the CRS, in order to qualify as a Participating Jurisdiction, an 'agreement' must be in place pursuant to which the jurisdiction will provide the information required by the CRS, including account balances, gross amounts of income, etc, and the jurisdiction must appear on a published list.[113] However, none of the FATCA Model 1 reciprocal IGAs can be considered to be an agreement within the meaning of the CRS. These IGAs only provide for outbound automatic exchange with respect to certain types of US source income, which falls far short of the CRS requirements to report account balances, gross amounts of interest, dividends, capital gains and other sources of income. In addition, since the US does not require its FIs to Look Through legal entities, the IGAs cannot be said to otherwise comply with the CRS. The DTTs and TIEAs of the US would also fail to qualify for the same reasons.

If the US decides to comply with the CRS, regardless of whether it executes the MCAA or amends its IGAs to comply with the CRS, Congressional action may be required. The IRS may not have the statutory authority to expand the information presently collected from US institutions and exchange such information with foreign tax authorities. Since Republicans now control both houses of Congress, and FATCA passed with little Republican support, any expansion of FATCA would likely face serious Republican opposition in Congress. Moreover, the Republicans are wary of the OECD's role as a global tax policeman.

Jurisdictions that have determined to treat the US as a Non-Participating Jurisdiction may have placed a heavy administrative burden on their own Reporting Financial Institutions, as well as on US Type B Investment Entities. This may lead to undesired consequences, possibly greater outflows from such jurisdictions and inflows into the US as these US entities reconsider their foreign banking operations.

SWITZERLAND

In its Global Forum Phase 1 Peer Review, Switzerland was deemed to be non-compliant with certain aspects of the OECD's international standards and was blocked from moving to Phase 2.[114] The Global Forum cited a number of deficiencies, including deficient mechanisms to identify beneficial ownership of Swiss bearer share companies and domiciliary companies, the lack of legal authority to access bank information under the older DTTs except in cases of tax fraud, etc. In addition, none of Switzerland's existing DTTs were found to be compliant with the standard. Finally, taxpayer due process rights, requiring notice and hearing with rights of appeal prior to information exchange, were found to be inconsistent with the standard. As a result, Switzerland was deemed ineligible to move to Phase 2. However, in March 2015, after successful completion of a Supplementary Phase 1 Peer Review,[115] Switzerland was deemed eligible to move to a Phase 2 Peer Review.

Historically, Switzerland did not exchange information on tax matters, and its DTTs did not include exchange-of-information clauses. This practice evolved over time and more recent DTTs included exchange-of-information clauses limited to cases involving *tax fraud*,[116] which normally requires forgery or falsification of books and records (false accounting), and is a misdemeanour punishable by up to three years' imprisonment, as distinguished from tax evasion,[117] which usually consists of failure to report income and is also a misdemeanour but is punishable only by a fine. However, in March 2009, Switzerland withdrew its reservations to article 26 of the OECD Model Tax Convention, abandoned the distinction between tax fraud and tax evasion, and endorsed the OECD's 'foreseeably relevant' standard.

Switzerland has undergone enormous changes since adopting the OECD's on-request exchange-of-information standard. It addressed the shortcomings identified by the Global Forum by enacting the *Tax Administrative Assistance Act* in February 2013, which, *inter alia*, enables Swiss tax authorities to obtain information from financial institutions and exchange such information pursuant to treaty requests in line with the

113. CRS, section VIII, subparagraph D(5), page 57

114. Bit.ly/1V9Bcms

115. Bit.ly/1U4C64l

116. See article 186 of the *Federal Law on Direct Federal Tax*, and article 59 of the *Federal Law on Harmonisation*

117. See articles 175–180 of the *Federal Law on Direct Federal Tax*, and article 56 of the *Federal Law on Harmonisation*

> **Switzerland has repeatedly cited the importance of confidentiality safeguards and stated that it will give priority to countries with which it has 'close economic ties and which provide their taxpayers with sufficient scope for regularisation'**

OECD's on-request standard. Switzerland has a network of some 102 DTTs, 53 of which are in line with the OECD standard, and has also executed ten TIEAs in line with the standard.[118] In addition, Switzerland executed a Protocol to join the amended Convention on 15 October 2013, which was ratified by its parliament in December 2015, but is not yet in effect.

Switzerland endorsed the CRS in May 2014, and executed the MCAA in November 2014. The Swiss parliament ratified the MCAA in December 2015, as well as its implementing legislation, the *Federal Act on the Automatic Exchange of Tax Information* (AEOI Act).[119] The AEOI Act authorises automatic information exchange through two channels: pursuant to bilateral instruments that meet the requirements of the CRS; and pursuant to the MCAA. In order to implement automatic information exchange with partner jurisdictions under the MCAA, Switzerland must establish separate bilateral agreements with such partner jurisdictions and file notifications with the OECD Secretariat. Such bilateral agreements must also be ratified by parliament. In a very clear expression of the relevance of confidentiality and regularisation, the AEOI Act expressly provides that the Swiss government (*Conseil Federal*) should consider the existence of these two elements before proposing any jurisdictions to the Swiss parliament for automatic exchange.[120]

Under the AEOI Act, Swiss Financial Institutions will be required to conduct due diligence to identify Reportable Persons that are tax-resident in Reportable Jurisdictions, and will be further required to report such persons to the Swiss Competent Authority (Administration Fédérale des Contributions (AFC)) in 2018 with respect to tax year 2017. Such information will be transmitted by the AFC to the Competent Authorities of Reportable Jurisdictions. Switzerland has not yet published its list of Participating Jurisdictions. In respect of the optional CRS provisions authorised by the AEOI Act, Swiss Financial Institutions may apply the same due diligence standards to low-value accounts as are required for high-value accounts, and similarly may apply the same due diligence standards to pre-existing accounts as are required for new accounts. In addition, Swiss FIs may apply a *de minimis* threshold of USD250,000 for pre-existing entity accounts. Swiss Financial Institutions may also align the treatment of Discretionary Beneficiaries of trusts that are passive NFEs with the treatment of Discretionary Beneficiaries of trusts that are FIs.

Thus far, Switzerland has agreed to automatic information exchange under the CRS with nine jurisdictions and the EU. The agreements with Australia, Canada, Guernsey, Iceland, the Isle of Man, Japan, Jersey, Korea and Norway were all executed under authority of the MCAA. However, the agreement with the EU was entered into by way of a bilateral instrument amending the EU-Swiss Savings Agreement.[121] Under these automatic-exchange-of-information agreements, all of which must be ratified by the Swiss parliament, information will be exchanged in 2018 for tax year 2017. For the purposes of reporting by Swiss FIs, these nine jurisdictions and the 28 member states of the EU will be treated as Reportable Jurisdictions. More are sure to follow.

Switzerland has repeatedly cited the importance of confidentiality safeguards and stated that it will give priority to countries with which it has 'close economic ties and which provide their taxpayers with sufficient scope for regularisation'.[122] Switzerland is mindful of the importance of mitigating outflows to other financial centres by selecting counterparties that implement regularisation programmes prior to automatic

118. Bit.ly/1M56n00

119. *Loi fédérale sur l'échange international automatique de renseignements en matière fiscale* (18 December 2015)

120. Article 38 of the *Loi fédérale sur l'échange automatique de renseignements en matière fiscale*

121. Protocol between the EU and Switzerland, 27 May 2015, amending the EU-Swiss Savings Agreement that came into effect in 2005

122. Federal Council press release, 20 January 2016

exchange of information.[123] Switzerland has also cited the principle of *speciality*, which requires that exchanged information be used only for tax purposes, and that information exchange should be *reciprocal*. Due to the fact that Switzerland will give priority to countries with which it has close economic ties, it is unlikely that developing countries would be selected for automatic exchange in the near term.

Notwithstanding voluntary disclosure programmes announced in many countries, Switzerland is nonetheless suffering outflows to financial centres that have not committed to the CRS, in particular the US, and has stated that it expects competing financial centres to comply with the CRS.[124] Switzerland may also join other jurisdictions and decide to treat the US as a Non-Participating Jurisdiction, which would require Swiss Reporting FIs to treat all Type B Investment Entities resident in the US as passive NFEs, and Look Through and report their Controlling Persons. However, treating the US as a Non-Participating Jurisdiction may in fact increase outflows from Switzerland to the US. It may be wiser for Switzerland to include the US on its white list of Participating Jurisdictions.

CONCLUSION

Every major financial centre except the US has accepted the OECD's automatic standard, and the vast majority of offshore financial centres have followed suit. This bears witness to the outsize power wielded by the OECD, an organisation with no sovereign authority over any country.

The CRS requires Reporting FIs to determine whether trusts are FIs or NFEs. In the case of trusts that are FIs, Reporting FIs should report settlors as to the entire value of the trust fund, regardless of whether the trusts are revocable or whether the settlors are excluded from benefit, and must also report the value of payments made to settlors. Mandatory Beneficiaries should be reported as to the entire value of the trust fund, as well as to the value of any distributions made to them. However, Discretionary Beneficiaries must only be reported as to the value of distributions actually made. In the case of trusts that are passive NFEs, the Controlling Persons, including the settlors, trustees, protectors and beneficiaries, must each be reported as to the entire value of the trust fund and the entire value of income paid to the passive NFE trusts. Indeed, the all-important entity-classification process leads to dramatically different reporting outcomes.

The ultimate aim of the CRS is global tax transparency. However, these are early days. Presently, there are only 80 signatories to the MCAA, which leaves more than 100 jurisdictions that have not committed to the CRS. Although the Early Adopters have committed to begin exchanging information with each other in 2017 for tax year 2016, real compliance remains to be seen. Under the MCAA, it is clear that signatories will retain control over which exchange relationships they enter into, and may decline exchange relationships with countries that do not meet their confidentiality standards. The OECD has recognised that developing countries face special challenges in this regard. Notwithstanding, the leading financial centres that have signed the MCAA or committed to the CRS will be under pressure from the Global Forum to exchange information with a relevant number of counterparties. For most financial centres, this promises to be a zero-sum game. Difficult choices will have to be made, balancing economic self-interest against the threat of sanctions from the OECD.

The US has not committed to the CRS and has far lower reporting standards under FATCA, and does not Look Through legal structures and arrangements. As a result, financial centres are suffering outflows, and a number of jurisdictions have already determined to treat the US as a Non-Participating Jurisdiction and will likely invoke the CRS anti-abuse measures. Notwithstanding, unless the US commits to the CRS, the OECD's new automatic standard may well be severely undermined. Financial centres suffering increasing outflows may determine to implement the CRS judiciously while others may consider abandoning the CRS altogether.

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123. Federal Department of Finance, *Questions and Answers* (8 October 2014), page 2
124. Federal Department of Finance, *Questions and Answers* (27 May 2015)

GLOSSARY

Account Holder. The person listed as the Account Holder by the Financial Institution, regardless of whether the entity is fiscally transparent.

Beneficiary, Discretionary. A beneficiary with no entitlement or rights to income or capital in the trust fund.

Beneficiary, Mandatory. A beneficiary that has a fixed interest in the trust fund, either as to income or capital, which interest can typically be valued, and is not normally payable at the discretion of the trustee.

Controlling Persons. The natural persons who control passive Non-Financial Entities. In the case of trusts, Controlling Persons include the settlors, the trustees, the protectors and the beneficiaries.

Early Adopters. Those countries that signed a joint statement agreeing to early implementation of the CRS, and committed to exchange information for tax year 2016 by September 2017 among fellow members of the group.

Equity Interest. The interest held in Type B Investment Entities, such as a trusts, investment companies or funds. In the case of trusts, the settlors and beneficiaries are considered to be Equity Interest holders. In the case of corporations or partnerships, the shareholders or partners are considered to hold Equity Interests.

Financial Account. An account maintained with a bank, a securities or brokerage firm, and Debt or Equity Interest in a Type B Investment Entity.

Financial Assets. The CRS definition of Financial Assets is broad, and includes the shares of unlisted companies, such as underlying investment companies, but expressly excludes real estate.

Financial Institution. A Custodial Institution, a Depository Institution, an Investment Entity or a Specified Insurance Company.

Financial Institution, Non-Reporting. Governmental entities, central banks, international organisations, certain types of retirement funds, exempt collective investment vehicles, and trusts that are Financial Institutions where the trustee is a Reporting Financial Institution.

Financial Institution, Reporting. Any Financial Institution that is not a Non-Reporting Financial Institution, except excluded entities.

Gross Income test. The Gross Income test is the first part of the two-pronged test designed to determine whether an entity is a Financial Institution or a Non-Financial Entity. This first prong of the test is met if 50 per cent or more of the entity's gross income derives from investing or trading in Financial Assets during a defined period of time.

Investment Entities, Type A. Entities that primarily invest, manage or administer Financial Assets for customers. These are typically trust companies and asset-management companies.

Investment Entities, Type B. Entities that derive more than 50 per cent of their income from Financial Assets and that are professionally managed by Depository Institutions, Custodial Institutions, Specified Insurance Companies, or Type A Investment Entities. These are typically trusts, investment companies, and mutual funds.

Look Through. In the case of passive Non-Financial Entities, the requirement to disregard the corporate form and identify the ultimate natural persons who control the entity.

Managed By test. The Managed By test is the second part of the two-pronged test designed to determine whether an entity is an Financial Institution or a Non-Financial Entity, and means an entity that is managed by a Depository Institution, Custodial Institution, Specified Insurance Company, or Type A Investment Entity. The Managed By test requires the managing entity, such as a trust company or asset manager, to manage the assets of the managed entity with discretionary authority.

Non-Financial Entity, active. An entity that receives less than 50 per cent of its income from Financial Assets, and less than 50 per cent of whose assets produce or are held for the production of passive income.

Non-Financial Entity, passive. Typically, an entity that derives more than 50 per cent of its income from Financial Assets but that does not meet the Managed By test because its assets are not managed with discretionary authority by a Financial Institution. In addition, Type

B Investment Entities resident in Non-Participating Jurisdictions are treated as passive Non-Financial Entities.

Participating Jurisdiction. A jurisdiction with which the home jurisdiction of the Reporting Financial Institution has an agreement to receive the information specified in the CRS and which appears on a published list. During the initial phase of the CRS, the term Participating Jurisdictions also means jurisdictions that have committed to implement the CRS.

Participating Jurisdiction Financial Institution. A Financial Institution that is tax-resident in a Participating Jurisdiction.

Reportable Account. An account held by a Reportable Person or by a passive Non-Financial Entity with one or more Controlling Persons that is a Reportable Person, except excluded accounts.

Reportable Jurisdiction. A jurisdiction with which the jurisdiction of the Reporting Financial Institution has an agreement to provide the information specified in the CRS and which appears on a published list.

Reportable Person. An individual or entity that is tax-resident in a Reportable Jurisdiction. Exceptions include listed companies or their related entities, governmental entities, international organisations and Financial Institutions.

Wider Approach. The due diligence procedures that some jurisdictions may adopt that would require Reporting Financial Institutions to conduct due diligence on all non-residents, instead of residents of Reportable Jurisdictions. In addition, the Wider Approach to reporting refers to reporting all non-residents to the Competent Authority, rather than just tax residents of Reportable Jurisdictions.